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ACTION WHA-00

INFO LOG-00 AID-00 CEA-01 CIAE-00 COME-00 CTME-00 INL-00
DODE-00 DOEE-00 ITCE-00 DS-00 EAP-00 EB-00 EXME-00
E-00 UTED-00 VCI-00 FRB-00 H-00 TEDE-00 INR-00
IO-00 LAB-01 L-00 MOFM-00 MOF-00 VCIE-00 NRC-00
NSAE-00 ISN-00 NSCE-00 OES-00 OMB-00 NIMA-00 EPAU-00
PM-00 ISNE-00 SP-00 IRM-00 SSO-00 SS-00 STR-00
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FM AMCONSUL CALGARY
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ALL CANADIAN POSTS COLLECTIVE
OECD POSTS COLLECTIVE
OPEC COLLECTIVE

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UNCLAS CALGARY 000670

STATE FOR WHA/CAN, EB/ESC/ISC, EB/PPD

USDOE FOR IA (PUMPHREY, DEUTSCH)

E.O. 12958: N/A
TAGS: ENRG, EPET, ETRD, PGOV, SENV, CA
SUBJECT: ENERGY ROUND-UP FOR OCTOBER 2006

REF: A) 05 CALGARY 631; B) CALGARY 596

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1. Coalition of Canadian Energy Trusts Demands Change in GOC's Taxation Plans

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The GOC's October 31 announcement to effectively ban income trusts prompted Calgary's various energy trusts to form a group that has branded itself the Coalition of Canadian Energy Trusts (CCET). The 40-member group, led by Calgary-based ARC Energy Trust, Paramount Energy Trust, Canadian Oilsands Trust, Penn West Energy Trust, and Enerplus Resources, claims to produce 20%

of Canada's daily oil and gas production. The CCET, which is seeking talks with Ottawa to explain the "unique" circumstances behind energy trusts claims that, in the last five years, trusts have invested some $10 billion in oil and gas development activities. They claim that, without energy trusts, overall production and associated royalties will decline.

Our understanding of energy income trusts is that generally they invest in fields deemed no longer economical for larger exploration and production companies. The trusts do not much engage in exploration, development, construction or manufacturing, but focus on ownership and management with a view to generating income. To quote one Calgary investment firm, "Trusts have played a critical role in taking over developed pools~from the juniors, exploiting them to the maximum very efficiently and allowing the juniors to do what they do best - explore". Because oil and gas wells have limited life spans, they eventually run out of oil or gas and, as a result, must periodically have a new public offering of shares to finance the purchase of additional properties. They are also subject to the vagaries of commodity markets: oil goes up; profits go up; distributions go up; and vice versa. Much of the distribution is tax free, because of flow-through depletion allowances and other deductions. Investment firms say it is too early to know what the final structure of income trusts will be, but many note that good reserves and long term production are going to stay the course.

Despite the outcry from the trusts themselves, several senior energy players out here have defended the GOC decision. Murray Edwards of Canaddian Natural Resources and Gwen Morgan (former EnCana CEO) have done so through the press. Among our other contacts, Paul Ziff of Ziff Energy Consultants (a well-regarded group) told us he thinks getting rid of the trusts is in the long-term interest of Canada, Alberta and the industry. He argues that because the trusts go very light on both exploration and new production, they are not a particularly good use of capital. Along the same lines, [redacted] B6 tells us privately that not only are the trusts a bad model for the industry, but the trust leaders have to be nuts to think that the PM would/could reverse field on behalf of a bunch of rich oil guys from Calgary. [redacted] B6 argues that rather than going public in a loud way, they should have calmly identified a couple of small fixes that would have helped with their transition and then tried to quietly sell those to Ottawa. [redacted] cooler heads to prevail before B6 too long and for the oil patch to weather this tempest just fine.

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2. TCPL Notes 2009 Target Date for "Keystone" Oil Pipeline

TransCanada Corp. (TCPL) CEO Hal Kvisle provided us with an update of the company's proposed "Keystone" oil pipeline, aimed at carrying 435,000 barrels of crude oil per day along a 2960-kilometer pipeline from central Alberta to U.S. Midwest markets near Chicago at Wood River and Patoka, Illinois. Kvisle told us that his Keystone pipeline project team credited the State Department for being "quite responsive" since the interventions over the past summer, adding that there is no particular assistance required at this point. Kvisle reiterated that, within the U.S., TCPL requires permits from the states of North and South Dakota, Nebraska, and Illinois, and now that the State Department is "on track", TCPL's efforts have shifted to applying for and expediting the permits from the various states. TCPL has also made application to the National Energy Board

(NEB) for approval to convert the pipeline from natural gas to oil (reftel), and has come up against opposition from Calgary firms that claim the conversion will expose them to the risk of a substantial loss of gas sales (ref B). Those hearings continue. In the meantime, while TCPL said it will be challenged to meet its targeted in-service date of late 2009, it claims the pipeline will be in operation before any competing pipeline including those proposed by Calgary-based Altex Energy or Enbridge Inc.

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3. ~Don't Discount the Altex Bullet to the Gulf Coast

And those competitors are lining up at the gate~Altex Energy President Jack Crawford recently provided an update of the company's proposed $3 billion oil pipeline, aimed at delivering 250,000 bpd of heavy crude along a 2000-kilometer pipeline from Alberta to the U.S. Gulf Coast (ref A). Crawford, a co-founder of the very successful $5.8 billion Alliance natural gas pipeline, told us that Altex is in commercial negotiations with shippers and is not expected to file a proposal with regulators until those negotiations are concluded. With respect to the competition, Crawford pointed out that TCPL services a different

market, and added that its volumes will exceed those of TCPL's proposed Keystone pipeline as Altex plans to increase capacity to as much as 750,000 bpd. Crawford admitted that the 2010 in-service date might be a bit of a stretch, but appeared confident that shipper commitments would come through (although he pointed out that the anticipated four months of negotiations had turned into more than a year). Crawford also acknowledged that his company has yet to negotiate with landowners along the route and added that he expects eminent domain to be part of the Altex equation. He argued that you should not open the eminent domain can of worm until you are fully prepared to work through the process. (Note: As an aside, [redacted] B6
recently B6
described the Altex proposal to us as a "pipe dream". [redacted] B6
added that Suncor is a "big supporter" of the TCPL Keystone project). We would only note Crawford got Alliance built - and it was once considered a pipe dream.

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4. Enbridge Proposes $140 Million Expansion to the "Alberta Clipper"

In the meantime, Enbridge Inc. has proposed a US$140 million expansion of its "Alberta Clipper" project, first announced in February. The Clipper is a new US$1.8 billion, 1590-kilometer oil pipeline between Hardisty, Alberta and Superior, Wisconsin also aimed at meeting growing demand in the U.S. Midwest. Enbridge CEO Pat Daniel said the Clipper has gone from being a contract pipeline for one or two or three parties to the industry saying, "This is a broadly needed facility and capacity". The expansion will increase capacity to 450,000 bpd from 400,000 bpd of Alberta crude, and can later be expandable up to 800,000 bpd. The project is expected to be in-service by late 2009. Daniel added that the expansion was also prompted by industry moves including ConocoPhillips and EnCana's $15 billion deal to ship Alberta crude to U.S. refineries. Daniel said Enbridge is moving almost all it can through its pipeline system.

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5. Alberta Energy & Utilities Board Reports Oilsands Reserves Annually

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Alberta Energy and Utilities Board (EUB) Chairman Neil McCrank told us recently that his board is trying to contend with the same labor shortages as everyone else in Alberta's oilpatch. McCrank, who has been at the helm of the EUB since 1998, said

the EUB currently employs some 800, up from less than 600 shortly after he came on board. A lawyer and engineer by trade, McCrank claims that the EUB, which oversees everything from applications for oilsands development, coalbed methane, electricity transmission lines, and environmental protection, has responded well to industry demands that continue to stretch the board's resources, but they are running at full tilt. With responsibility for reporting Alberta's oilsands reserves, currently an estimated 175 billion barrels, McCrank pointed out that reserves are reported annually using a per barrel price of $25-$30. The EUB Chair noted there are three regions in Alberta - the Athabasca, Peace River, and Cold Lake that occupy nearly 140,800 square kilometers. The 175 billion barrels of reserves are contained in the Athabasca region alone, and does not take into account reserves from the Peace River or Cold Lake regions. McCrank indicated he would take a go-slow approach on raising the reserve level, but he made clear that once the base price of oil is raised (an ongoing debate around the industry) and Peace River and Cold Lake are included, the number is going up. McCrank also seems to be looking for the next generation of SAG-D in situ production to go from experimental wells to large scale production. The bottom line would appear to be that once these moves are made, which could take one year or several, that EUB will probably raise Alberta's proven recoverable reserves to the 300 billion barrel range.

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6. NEB Chairman Says Relationship with FERC "Excellent"

In recent discussions with Ken Vollman, the Chairman of the National Energy Board was eager to point out the excellent relationship the NEB has shared with the Federal Energy Regulatory Commission (FERC) over the years. Vollman noted the MOU that was signed by the NEB and FERC several years ago and the important role it has played in keeping the lines of communication open between the two federal regulators. Vollman is confident that this information sharing will continue under

new FERC Chairman Kelliher, who recently attended the North American Forum in Banff, Alberta. Vollman recently delivered a presentation to the World Forum on Energy Regulation in Washington, D.C. and pointed to some of the highlights of his presentation, including NEB forecasts that call for natural gas production to remain flat at the current level of 17 bcf/day. Vollman stated that it is not unreasonable to assume that North American gas demand could grow by 16 bcf/day by 2020 and, since supply from traditional sources is not expected to grow by more than 2 bcf/day, there could be a potential gap of some 14 bcf/day. Of course, industry maintains that all sources of gas supply will need to be tapped, but Vollman also asked what will be the effects of a huge step entry of Alaska gas into the market, and can it compete with smaller re-gasification terminals?

Vollman, who continues to conduct hearings throughout communities in the Northwest Territories as they affect the proposed Mackenzie Valley natural gas pipeline, offered the NEB's approximate sequence of events for the project. Vollman pointed out that the Joint Review Panel (JRP) and the NEB are conducting simultaneous hearings, and expects the NEB hearings to be concluded by the end of 2006, at which time it will adjourn until 2008 when it is expected to release its findings. The JRP, in the meantime, will continue hearings and prepare its report before the end of 2007. The Government response will be released by mid-2008 at which time, licenses and permits will be granted, if authorized. As an aside, Vollman said much time gets eaten up by environmental and sociological issues that are outside NEB's jurisdiction. It is unclear at this time how big the impact of a Canadian court decision requiring further consultations with the Dene tribe will have on the process, but it could cause further delays.

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7. TCPL Says Room for Alberta to Grow as Larger Electricity Exporter

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TransCanada Corp. (TCPL) CEO Hal Kvisle claims Alberta has become a larger electricity exporter, but regulatory uncertainty

and transmission shortfalls are keeping additional investment at bay. Kvisle believes there are "many, many good co-generation" opportunities related to industrial development in the province and he believes Alberta should be as committed to electricity

exports as it is to gas and oil exports. Generating electricity is becoming a larger part of TCPL's operations, particularly as natural gas transmission growth wanes as a result of a maturing Western Canadian basin. Transmission constraints remain a major issue in Alberta, even with $1 billion in projects on the drawing board. Most new capacity will simply reinforce the existing system rather than facilitate new generation or boost export capacity. The Alberta Electric System Operator (AESO), which oversees transmission in the province, said $3 billion or more in new transmission projects could be required over the next 10-15 years. [redacted] noted to us how hard it is B6
even to get the locals to agree to a new Edmonton-Calgary transmission line, so expanding electricity distribution may be as hard here as in the rest of North America.

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8. Saskatchewan Primes for Oilsands Exploration

The Province of Saskatchewan is gaining attention in the oilsands arena, as a Calgary-based company recently conducted the province's first oilsands drilling program in more than three decades. Oilsands Quest Inc. said its search for Athabasca bitumen in northwestern Saskatchewan is yielding encouraging results, noting that the Athabasca oilsands basin has been mapped to within 20 kilometers of the Saskatchewan border. Industry and Resources Minister Eric Cline said the province recognizes that Saskatchewan's known oilsands resources are neither as vast nor as close to the surface as Alberta's riches, but there is evidence that may eventually prove amenable to thermal production. Industry officials claim that, despite the province being Canada's second largest producer of heavy crude (behind Alberta), and the country's third largest natural gas producer (behind Alberta and B.C.), the province is not as competitive and producers tend to bypass it because of higher royalties and taxes, but the province said it is in the process of creating a competitive bidding system for awarding oilsands leases by public tender and has an incentive similar to Alberta's royalty regime already in place. As well, in 2005, Saskatchewan introduced tax credits for enhanced oil recovery, designed to encourage companies to invest in more heavy oil plays. That came after it lowered royalties and cut provincial taxes on CO_2 used in aging oilfields to help launch EnCana's carbon sequestration project at Weyburn, Saskatchewan. The largest prize in Saskatchewan lies with heavy oil, as only about five percent of the 25 billion barrels of the province's

estimated reserves are recoverable with current methods.

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